



Patrick H. Merrick, Esq.
Director – Regulatory Affairs
AT&T Federal Government Affairs

Suite 1000
1120 20th Street NW
Washington DC 20036
202 457 3815
FAX 202 457 3110

December 4, 2002

Via Electronic Filing

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W., Room TW-B204
Washington, DC 20554

Re: Notice of Ex Parte Presentation: CC Dockets No. 96-45, 98-171, 90-571, 92-237,
99-200; 95-116, 98-170 and NSD File No. L-00-72.

Dear Ms. Dortch:

Today, Robert Quinn, Joel Lubin, and I met with Christopher Libertelli, Legal Advisor to Chairman Michael K. Powell, to discuss reform of the Commission's universal service contribution mechanism. AT&T has supported and continues to support significant revision to the current revenue-based assessment mechanism by adopting an approach based upon telephone numbers as proposed in AT&T's ex parte dated October 22, 2002. However, in the event that the Commission adopts an interim approach that retains many of the aspects of the current system, AT&T requests several changes to address the inequities inherent in the existing methodology. These changes are described in detail in the attached letter which was used as an outline for our discussions.

Consistent with the Commission rules, I am filing one electronic copy of this notice and request that you place it in the record of the proceedings.

Sincerely,

A handwritten signature in black ink, appearing to read "Patrick H. Merrick".

Attachment

cc: Christopher Libertelli



Robert W. Quinn, Jr.
Federal Government Affairs
Vice President

Suite 1000
1120 20th Street NW
Washington DC 20036
202 457 3851
FAX 202 457 2545

December 4, 2002

Via Electronic Filing
EX PARTE

Ms. Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: CC Dockets No. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, and
NSD File No. L-00-72

Dear Ms. Dortch:

AT&T Corp. ("AT&T") files this *ex parte* to assist the Commission in addressing the reform of its universal service contribution mechanism. AT&T has supported and continues to support significant revision to the current revenue-based assessment mechanism by adopting an approach that assesses carriers based upon telephone numbers as proposed in the AT&T *ex parte* letter submitted in this proceeding on October 22, 2002. In the event, however, that the Commission adopts an interim approach that retains many aspects of the revenue-based mechanism, AT&T requests several changes, similar to ones it has previously recommended, that are necessary to address the inequities inherent in the existing assessment methodology.

In addition, should the Commission move to an interim solution that is based in part on the current revenue assessment situation, it must permit carriers (1) to retain flexibility in how each carrier chooses to structure its universal service end-user recovery mechanism to recover that expense from customers and (2) to collect all legitimate direct expenses associated with administering the universal service contribution program required by the Act.

Rate Structure

Assuming that the Commission implements an interim revenue-based approach, all carriers should retain the flexibility to recover their USF obligations from end user customers under either a revenue-based or flat monthly rate structure. Preserving these options are necessary to avoid competitive inequities as between traditional IXC's and (1) wireless carriers who could increasingly choose to bill USF to their customers on an account, line or a number basis, (2) pure play international carriers that are not required to contribute to USF on their

international revenues if their domestic interstate revenues are less than 12% of their total interstate and international revenues should the Commission decide to maintain the international exemption, and (3) bundled offers where carriers have some flexibility to assign their revenues to that portion of a bundle that is not assessed USF obligations. Carriers today in each of these industry segments are utilizing the flat-rate and percentage of revenue mechanisms to recover universal expense from their end user customers. As competition between these industry segments continues to accelerate, carriers must retain the flexibility to structure their universal service recovery in the same manner as their competitors.

Indeed, the Commission must ensure that any action taken in this area be done in a completely nondiscriminatory fashion. For example, if the Commission were to issue an Order in this proceeding that required interexchange carriers only to assess their collection rate on a percentage of revenue basis, those carriers could be competitively disadvantaged in competing with a carrier (wireless or wireline) who assessed its universal service recovery charge on a flat-rate basis. Carriers must maintain the ability to competitively respond to changes in the marketplace. That flexibility is increasingly important as bundled service offerings become more prevalent. Obviously, any Commission-mandated rate structure, such as the uniform line-item associated with the collect-and remit proposals, that forces carriers into a competitively inequitable situation would violate Section 254(d)'s requirement that the USF program be "equitable and nondiscriminatory."

Direct Expense

The Commission must permit carriers to recover all direct expense associated with the universal service program. That expense includes the costs directly incurred to administer the entire assessment and collections process.

Unbillable Revenues

Unbillable revenue issues occur when a carrier is unable to bill a particular customer or class of customers for the costs associated with universal service contribution that the customer or class of customers has caused the carrier to incur. There are many examples of "unbillable revenue" situations that the Commission has previously identified and attempted to address. This most obvious example of this problem stems from the "revenue lag" caused by the fact that the existing USF methodology assesses carriers based on interstate revenues received from six months ago. As AT&T has repeatedly demonstrated in this proceeding, a carrier whose interstate revenues are declining cannot bill the customers who caused the carrier to incur universal service expense, because six months later those revenues are "gone" from the carrier's revenue stream when it must collect that expense from its revenue base. Consequently, the carrier must increase its collection rate to all end users in order to be in a position to fully recover its universal service expense. Despite acknowledging that this revenue lag situation is a "competitive disadvantage" to carriers with declining interstate revenues (and reducing the lag from 12 months to six months),¹ the Commission has never modified the methodology to eliminate the lag in its entirety. AT&T requests that the Commission do so expeditiously on an interim basis to be implemented on April 1, 2003.

¹ In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Order, FCC 01-85, ¶¶ 13, 14 (Mar. 14, 2001).

In addition to the lag, carriers experience other circumstances that prevent them from billing universal service expense to specific customers who caused the carrier to incur such expense. For example, AT&T faces "unbillable revenue" in circumstances where AT&T does not have a billing relationship with its end user customer, as occurs in many independent company areas or with casual calling. It also manifests itself when customers assert contractual provisions preclude AT&T from billing the USF line item to them.

The two most significant unbillable revenue streams stem from: (a) the smaller independent, more rural incumbent LECs; and (b) the RBOCs that bill "casual" calling on customer accounts where AT&T is not the presubscribed interexchange carrier. In both instances, AT&T receives interstate revenue from the LEC upon which it is assessed USF contribution by USAC. AT&T, however, has no means to collect its USF assessment from its end user customer unless the billing LEC agrees to put a line item on the bill to recover that charge.

In the past, unbillable revenues constituted one of the primary reasons (along with the "lag" and uncollectible expense) that AT&T's USF line-item recovery rate for all its customers exceeded the assessment rate imposed by USAC. The fact that AT&T could not collect the USF expense directly from particular customers did not change the nature of that expense to AT&T. AT&T was still required to submit monies into the USF to cover the assessment. In essence, AT&T used an averaging methodology to spread that expense to its entire "billable" rate base.

That is not to say that AT&T has not attempted to reduce the amount of revenue that falls into the unbillable category. It has. Indeed, AT&T made repeated efforts to get the Bell companies and many independent companies to add a line item on the end user bill to permit recovery of the USF assessment on a customer-by-customer basis. Those efforts were successful with some independent companies who, in the past few years, have agreed to bill a USF line item. With the Bell companies and several hundred smaller independent companies, the response has ranged from outright refusal to even consider the line item addition to "price quotes" to the asserted need to "upgrade" billing systems in order to add the line charge. For carriers that refused to add the line item, AT&T had no alternative method to recover those costs from those customers. For carriers that sought exorbitant cost recovery for massive upgrades of systems to recover the line item (and given that there are hundreds of independent companies), AT&T's only alternative would have been to pay millions of dollars for other carriers' system upgrades (which would have taken months to accomplish in any event) and then increase its already competitively hampered collection rate to recover those direct costs.

The suggestion has been made that perhaps the Commission could assert an upper bound on the recovery rate charged by carriers to their end user customers without addressing this "unbillable revenue" that results in AT&T and similarly-situated carriers incurring universal expense but not having any mechanism now or in the future to collect that expense. Imposing a rule that limits a carrier's recovery rate but does not provide a means to recover against unbillable revenues would prevent AT&T and similarly-situated carriers from recovering legitimate universal service expense. A restriction of that type would be unlawful and a direct violation of the Act.

The source of the variations in universal service surcharges among telecommunications carriers stems from the fact that each individual telecommunications carrier bears all of the risk

of not recovering its universal service obligations from its customers, which, as the Commission has recognized, forces carriers to “engage in complex calculations to account for such variables as uncollected revenues, credits and the need to recover universal service contributions from a declining revenue base.” *NPRM*, FCC 02-43, ¶ 23 (Feb. 26, 2002). ¶ 23. And because each carrier faces a different risk of nonrecovery, their good faith efforts to fashion recovery mechanisms *inevitably* result in line-item charges of substantially varying amounts.

The Commission cannot limit carriers’ pricing flexibility to set the amount of their USF recovery charges without eliminating carriers’ risk of nonrecovery. As long as an individual carrier bears its own risk of nonrecovery, that carrier must be allowed to adjust its line-item charges for universal service to account for that risk. Otherwise, a carrier with a low individual risk of nonrecovery could fully recover its universal service obligations from the prescribed line-item charge, whereas a carrier with a high risk of nonrecovery could collect only a portion of its universal service obligations from the prescribed line-item surcharge and would be forced to collect the remaining balance through its basic rates. That result plainly is not competitively neutral.

Moreover, by effectively forcing certain carriers to recover universal service obligations through rates, the Commission would be maintaining an implicit universal service subsidy in violation of § 254(e). 47 U.S.C. § 254(e). As the Fifth Circuit has held three times now that “the plain language of Section 254(e) does not permit the Commission to maintain any implicit subsidies.” *COMSAT Corp. v. FCC*, 250 F.3d 931, 938 (5th Cir. 2001) (Commission may not even permit the maintenance of implicit subsidies).² And to allow recovery of universal service contributions through basic service rates would unquestionably constitute an implicit subsidy.

In the past, the Commission has gone to great lengths to ensure that it could assess, and carriers could collect, their universal service contributions. For example, wireless carriers asserted that they could not identify interstate revenues for individual customers or on a company-wide basis, without significant difficulty given their then-existing business practices. In response to those arguments, the Commission created the “wireless safe harbor” pursuant to which wireless carriers are permitted to report 15% of their revenues which are assumed to be interstate for assessment purposes (and are required to corroborate the percentage only if they report a lower percentage of revenues). *See, e.g., Federal-State Joint Board On Universal Service*, CC Docket No. 96-45, FCC 98-278 (adopted October 22, 1998, released: October 26, 1998). The wireless carriers, in turn, assess their end users either a flat monthly charge or a percentage of all revenues (inter- and intra-state), as described below, again because the carriers were unable to distinguish interstate usage at the customer level.³

In essence, the wireless industry had an issue similar to the unbillable revenue issue

² *See also Alenco Comm. v. FCC*, 201 F.3d 608, 623 (5th Cir. 2000); *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 425 (5th Cir. 1999).

³ Wireless carriers generally assess a universal connectivity fee to each customer who signs up for wireless service irrespective of whether that customer makes any interstate calls. Those charges are assessed in two different manners: on a percent of total revenue or on a flat fee basis. Under a flat fee mechanism, the carrier assesses each customer or each telephone number a flat rate for universal service contribution irrespective of the customer’s revenues or usages (Cingular, for example, assesses each telephone number \$.55 per month). Other carriers, like AT&T Wireless and Nextel, assess universal service as a percentage of total revenues (usually in the range of 1%).

experienced by AT&T and the Commission solved the problem for wireless carriers. If wireless carriers had been forced to bill each individual customer based on the percentage of interstate revenues caused by that customer, according to those carriers, many of them could not have complied or could not have complied without significant expense. The FCC addressed that issue by creating the safe harbor and permitted those carriers to average their universal service expense against their entire customer base so that wireless carriers did not have to significantly change business practices to enable them to report and collect on interstate usage.

If the Commission were to adopt a policy here that constrained interexchange carriers from collecting legitimate universal expense incurred on revenues upon which the carrier was unable to bill (by constraining the upper bound of the collection percentage charged by carriers or prohibiting the utilization of per account or per line collection fee structures) but continued to allow wireless carriers to utilize "safe harbors" and to average universal service expense across their entire customer base, the result would be patently discriminatory and inequitable.

Further, suggestions have been made that AT&T should simply increase its rates in areas (or for services), which account for unbillable revenues. That solution raises two additional distinct issues that must be addressed. First, there is a potential conflict with the Section 254(g) requirement that IXC's charge customers for service in rural areas no more than they charge customers for service in urban areas (because the independent companies inability to render a separate line item for surcharge). Second, because AT&T could not break out the USF connectivity fee from the underlying revenues, it would be unable to distinguish the USF assessable component of these rates from the non-USF assessable component, it would once again be placed in the position of being assessed for USF contribution on USF revenues for those customers. The Commission recently corrected this anticompetitive ramification of the existing contribution mechanism. *Report and Order*, FCC 02-43, ¶¶ 113-115 (Feb. 26, 2002). Adopting a selective rate increase solution would reintroduce that problem for these customers.

Unbillable revenues are also an issue in contractual arrangements where the customers assert that contracts prohibit AT&T from assessing universal service contributions. While this problem has lessened as time passes, there are still instances where customers are asserting this prohibition. As in the situations described above, carriers are still assessed on those revenues whether the customer pays the charges or not. The Commission can rectify this situation by making it clear in its Order that no contributor or customer shall be permitted to rely on any provision in a contract for interstate telecommunications services to avoid the payment of the USF end user charge. This approach would tend to neutralize the differential collection rates among carriers. If the Commission is, however, unable or unwilling to make such a pronouncement, carriers should not be required to remit those revenues which they have no legal basis to collect and those revenues should be included in the unbillable revenue category described in the projected revenue methodology recommended below (*see Proposed Methodology*).

Wireless Safe Harbor and International Exemption

In principle, the Commission must eliminate the wireless safe harbor and international exemption that distort the market and provide strong incentives for customers to abandon full service wireline providers in favor of wireless carriers and pure play international carriers. To illustrate once again, presume a wireless carrier sells the two different customers bundled all distance offers for a flat monthly fee of \$100 (Customer A) and \$50 (Customer B), respectively.

Assuming even that the Commission raises the safe harbor from 15% to 30%, (which AT&T still contends is unlawful under the Act), that carrier would be assessed on \$45 revenue. Assuming a 10% assessment rate, the carrier will pay \$4.50 to USAC. The wireless carrier will pay that assessment even if 100% of those customer calls are interstate in nature.

By contrast, if AT&T served the \$100 and \$50 interstate long distance customers, AT&T would be required to contribute to the USF based on the full \$150 of those customers' interstate usage. Assuming the same 10% USF assessment rate, while the wireless carrier would contribute \$4.50, AT&T would contribute \$15 to the USF for the identical interstate usage. That discrepancy exists assuming that the interim fix addresses both the lag and unbillable revenues issues. If the Commission does not address those issues, the discrepancy would be even worse. One can easily see why the current mechanism distorts the competitive marketplace and provides powerful incentives for customers to place long distance calls over wireless networks.

The international exemption results in similarly discriminatory USF treatment as between a pure play international carrier and a full service provider. Assume an AT&T customer had \$1000 of interstate and international revenue in a given month, with \$120 of the total being interstate in nature, and the remaining \$880 being international. Because AT&T is not eligible for the international exemption, it would be assessed \$100 for USF (assuming a 10% USF assessment rate) and would be required to recover this cost from the customer, thus billing the customer a total of \$1100. Another customer, with the *identical* usage, but served by a carrier operating under the international exemption eligibility, contributes only \$12 to the USF (10% of \$120 interstate revenue; the international revenue is exempt). Thus, the pure play international carrier would charge its customer a total of \$1012, or \$88 less than what AT&T would bill its customer with identical usage. In fact, the customer of the "pure play" international carrier can have a greater percentage of interstate revenues, and still contribute less to the USF than a comparable AT&T customer. Indeed, because of the six-month lag, the "pure play" international carrier has up to six months to market this competitive advantage before it might be required to reclassify itself as a carrier no longer subject to the international exemption.

The AT&T-proposed telephone numbers-based assessment mechanism, would have eliminated the competitive inequities raised by the wireless safe harbor and the international exemption. Because the Commission is considering an interim approach that maintains aspects of the revenue-based mechanism, it should eliminate the wireless safe harbor and the international exemption in their entirety now.

Proposed Methodology

Given that modifying the current revenue-based methodology is designed to be temporary in nature, the Commission should adopt a projected revenue-based approach which would have the twin benefits of (1) eliminating the severely anticompetitive effect of the lag which discriminates against carriers with declining revenues and favors those with increasing revenues, and (2) using the current USF administrative structure thereby minimizing the burdens on contributors and USAC, specifically by not requiring significant systems changes to implement.

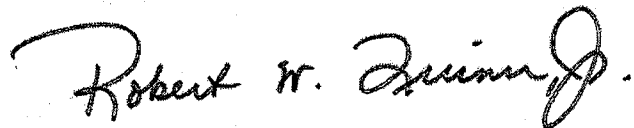
The Commission could operationalize a projected revenue approach using the current carrier submission and USAC billing timelines. The following illustrates this approach effective April 1, 2003 for second quarter 2003 USF funding. Carriers could file on February 1, 2003 projections of collected revenues for the second quarter 2003 with USAC using a Prospective

Form 499-Q. AT&T suggests that the projected revenue submissions provided by carriers estimate those revenues *that a carrier expects to collect from its end user customers* in the quarter, rather than billed revenues. This structure would reflect the fact that (1) not all customers pay their telecommunications bills and (2) some customers cannot be billed USF because of LEC refusal/inability to provide a USF line item on the bill (primarily a problem with smaller independent LECs and RBOC billing for casual calling). Those projections would then be the basis on which USAC calculates its assessment factor.

By February 15, 2003, USAC would calculate the revenue assessment rate for second quarter 2003 by dividing the projected USF funding requirements for the second quarter by the sum of the projected revenues obtained from the prospective 499-Qs as adjusted for IXC unbillable revenues. USAC would bill respective carriers based on their submissions according to the current billing schedule, *i.e.*, on April 15, May 15, and June 15. Carriers would then remit their contributions on May 15, June 15, and July 15, consistent with the current payment schedule. Carriers would true-up their second quarter actual revenues on their Form 499-Q for the second quarter that would be filed on August 1, 2003. Attachment A further illustrates the relevant filing points for the third and fourth quarter 2003 carrier submissions. By relying on the current schedule, this projected revenue approach can be implemented seamlessly and without delay.

In accordance with FCC rules, a copy of this letter is being filed in each of the above-captioned dockets.

Respectfully yours,

A handwritten signature in black ink, reading "Robert W. Quinn". The signature is written in a cursive style with a large, stylized "Q" at the end.

Enclosure

Attachment A

OPERATIONALIZING USF BASED ON PROJECTED REVENUES
Effective April 1, 2003 for 2nd Quarter 2003

- **Carriers file projections of revenues for the 2nd Quarter of 2003 with USAC (Prospective 499-Q) – February 1, 2003**
 - Carriers will file projections of anticipated “Collected” revenues, using same format of Form 499-Q.
 - IXC’s will identify “Unbillable” revenues (LEC billed revenues but no usf line-item, existing long-term contracts with no usf line-item), i.e., revenues for which there will not be a corresponding usf line-item in the 2nd Quarter.
- **USAC calculates the revenue assessment rate for the 2nd Quarter of 2003 by dividing the projected USF funding requirements for the 2nd Quarter by the sum of the projected revenues obtained from the Prospective 499-Qs. – February 15, 2003**
 - USAC adjusts assessment rate for IXC “Unbillable” revenues.
- **USAC bills respective Carriers based on their submissions according to the current billing schedule – April 15, May 15, and June 15**
- **All Carriers remit contributions according to current payment schedule – May 15, June 15, and July 15**
- **Carriers File Prospective 499-Q for 3rd Quarter with USAC – May 1, 2003**
- **Carriers File Form 499-Q for 2nd Quarter and Prospective 499-Q for 4th Quarter with USAC – August 1, 2003**
 - Form 499-Q is modified to reflect “Collected” revenues from the previous quarter.

OPERATIONALIZING USF BASED ON PROJECTED REVENUES
Effective April 1, 2003 for 2nd Quarter 2003
(cont'd)

- **True-up Mechanism¹ - Applied in 4th Quarter 2003**

- USAC compares Carrier projected revenues for 2nd Quarter Prospective 499-Q 2003 with actual revenue from August 1st Form 499-Q.
- USAC calculates the Carrier (plus/minus) adjustment to the 2nd Quarter assessment based on the difference between the projected revenue base and actual revenue base.
- USAC applies each Carrier adjustment as an increment to the 4th Quarter 2003 USF funding requirement²
- USAC settles with each Carrier based on the difference between its projected revenues for the 2nd Quarter and their actual revenues from their August 1st Form 499-Q.

¹ True-ups are applicable to any quarter for which usf assessments are based on carrier projected data. Adjustments are made to the usf assessments for the second quarter following the quarter that is based on projected data, i.e., the 2nd Quarter 2003 assessments are "trued-up" in the 4th Quarter 2003.

² If a Carrier's actual revenues for the 2nd Quarter 2003 exceeded the projections, then the 4th Quarter 2003 USF funding requirement can be lowered as the difference will be made up by USAC settlements with that Carrier. If a Carrier's projections for the 2nd Quarter 2003 exceeded actual revenues for that Carrier, then the 4th Quarter 2003 USF funding requirement must be raised to reimburse that Carrier who overpaid in the 2nd Quarter.